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# Economic Conditions
# Governmental Finance
# United States Securities

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## General Business Conditions

THE business news of November has repeated the October pattern of active trade, rising prices in most of the markets where prices are free to rise, and at the same time a lag, which so far has not been overcome, in lifting civilian production to the goals which manufacturers set for themselves after V-J day. In this inconsistent pattern is seen on the one hand the working of inflationary influences, which create demand without a commensurate output of goods, and on the other the effects of manpower scarcity and labor disturbances. The inflation thrives on the shortages. The drop in national income payments, which represent the money purchasing power of the country, since the end of the war has been smaller than most people expected, just as unemployment has been smaller; and accumulated savings have cushioned the decline and made it of little consequence in current trade. Department store sales, running 10 to 12 per cent above a year ago despite merchandise shortages, have been the highest ever reached at this time of year, and little doubt remains that Christmas business will break all records.

These trade figures — which have a counterpart in expenditures on travel, amusements, and other services — demonstrate again how greatly those who predicted a "reconversion depression" misjudged the situation. They overestimated the decline in employment and income. They underestimated the insistence of deferred demands, the general feeling of release at the end of the war, and the power of money to burn holes in pockets.

Industrial purchasing agents also are active. They are far more fearful of being caught short of raw materials and semi-manufactured goods, or of being left behind in advancing markets, than they are of price declines, — barring a few cases where surpluses are obvious. There is little evidence that they are overdoing forward buying, which in fact would be difficult because of market conditions and the inventory limitations still enforced from Washington. But in many of their requirements they are anxious to cover as far ahead as sellers will accommodate them. On the other hand, many sellers are protecting themselves by "escalator" clauses. Many do not know what their wage costs will be, what productivity to expect from their labor, or what action to expect from the Office of Price Administration on prices of what they buy or what they sell, and the uncertainties are an obstacle to business.

### The Underlying Influence

Underlying the prevailing desire to buy are of course the rising price of labor, represented by the spread of wage increases, the union demands still to be dealt with, and the interruptions of production through strikes. It is not the usual thing to list strikes as an inflationary factor, for it is an economic truism that where a loss of production occurs there is an equivalent loss of purchasing power. But the present situation is that there are sellers' markets in a host of products and a superfluity of money purchasing power to offset what the strikers and others affected lose. The loss of production of goods that are in eager demand is the important matter. As for the other factors, wage increases squeeze costs against price ceilings, and the logical conclusion is that the ceilings are minimums which for many products and many producers will have to be broken if labor gains any great part of its demands and the productive organization is to continue to function.

In the security markets the influence of the money supply and of low interest rates is evident in the higher stock prices. Doubtless another influence is also present, namely, a prevailing belief that a huge volume of peacetime business lies ahead and that the companies which share in it will profit. It would be hard to say whether the valuation of anticipated earnings at low yields, following the trend of rates on good bonds, or hope of speculative profit is the chief factor. In either case, the inflationary influence is apparent.

### The Need for Production

The industrial and trade situation thus briefly described would be gratifying if all the purchasing power employed were flowing from useful production and if the output of goods were coming more rapidly into balance with the demand. The danger, however, is clear. What is needed to put the situation on a sound basis is, most of all, larger and lower-cost production. It may be impossible, because of increased costs, to avert a wage-price spiral even with a substantial expansion of production. But without greater production most experienced observers will expect present trends to continue, — creeping if not walking or running.

The hindrances and delays in production which the industries are reporting are due principally to two causes. One is the continuing shortage of labor. The other is the prevalence of strikes, many of which have effects extending far beyond the plants immediately involved. Factories depend upon each other for the things they need, and this great interdependence in the industrial organization, which makes it easy for bottlenecks to develop, would be one of the difficulties of reconversion even if there were no labor troubles to contend with.

Strikes in single automobile parts plants have caused the complete shutdown of automobile assembly lines, resulting not only in the layoff of the automobile companies' own workers but in stoppage of deliveries from other parts manufacturers. Even before the General Motors strike was called shutdowns of this nature were running through the industry, due to lack of frames in one case, of transmissions in others, or of similar shortages elsewhere. A general scarcity of glass was threatened, due to strikes in two glass companies. Now comes the complete tieup of General Motors plants, which will affect other producers who buy parts from General Motors divisions.

It would be hard to measure the extent to which production of needed consumer goods has been put behind by these difficulties. More than the automobile companies are affected, however, and it is clear that the output of the industries which are reconverting will fall substantially below the levels which they believed they could reach by the end of this year. A large plant manufacturing electrical equipment reports that although it had planned and expected to equal its 1941 rate of output by the year-end and go on from there, it will actually reach only 40 per cent of its goal, due to shortage of parts. Even in lines which had no reconversion problem, labor shortages have imposed at least temporarily a brake on expansion. A recent statement by the Rubber Manufacturers Association revealed that tire output was falling 35 per cent below capacity, due to inability to obtain enough labor to keep plants going on a 6-hour day. Although the lumber shortage is acute, and an obstacle to construction revival, lumber output has been cut by strikes. Complaints of low output of workers are widespread.

It is deplorable that production should be retarded in this manner, for it means that supplies of goods are not up to anticipations, and shortages feed the inflation danger. The optimistic view of the outlook holds to the hope that the labor shortage, the low productivity and the general unsettlement are but a temporary phase of the shift from war to peace. In due course the desire for rest and change following the war tensions should wear itself out. Veterans will be coming back to the labor force eager to establish themselves and get ahead, which implies superior effort and productivity. If developments move in that direction and remaining tasks of physical reconversion are completed, the inflationary influences will run into greater production, by which alone they can be absorbed.

Strikes and demands for exorbitant wage increases, however, are in another category, for their solution is almost certain to be inflationary in nature, namely, by granting wage increases which will raise costs and, at least in the case of marginal producers, force price advances. Or if price advances are prohibited by the Government higher costs will depress production. Either outcome is inflationary.

### On "Maintaining Labor's Purchasing Power"

In the discussion of union demands for 30 per cent wage increases to compensate for return to the 40-hour week, with consequent elimination of overtime pay at premium rates, a central point is the claim that unless labor's take-home pay is maintained at the wartime peak, despite lessened hours of work, labor will suffer a decline in purchasing power which will have a deflationary effect upon the economy at large and prevent the expansion of peacetime employment and production so ardently desired by everyone.

Not only has this argument been repeated again and again by labor leaders and labor economists, but it has received strong support in highest government quarters. Thus in his wage-price speech on October 30, President Truman referred to an estimated drop, unless checked, of over $20 billion in annual wage and salary payments in private industry, which he said "is not going to do anybody any good — labor, business, agriculture, or the general public." "It is," he declared, "a sure road to wide unemployment." Conceding that there will have to be a drop in take-home pay, the

nation, he said, cannot afford to have that drop too drastic. "Wage increases," he continued, "are therefore imperative — to cushion the shock to our workers, to sustain adequate purchasing power and to raise the national income."

In similar vein was the statement by Reconversion Director John W. Snyder in a public address in October citing that "where the cut in the work week has been from 48 to 40 hours the reduction in take-home pay is 23 per cent," and concluding that "this wide reduction of pay can mean only one thing, that the workers would have to reduce their standard of living."

Again, on another occasion, Mr. Snyder said:

The take-home price of the essentials of life remains high; the worker's take-home pay has fallen. Squeezed in that vise, the worker can do only two things — either he gets more money, or he has to reduce his standard of living. With a reduced standard of living, he will buy less, the purchasing power of the market will suffer, and manufacturers will feel it ultimately in reduced orders.

This theory that wage increases are needed now to "sustain purchasing power" and "avert deflation" ought to be examined critically. Because of the importance of the wage factor in business costs we cannot afford to risk ill-considered judgments that may wreck the whole recovery program. Is it true that we face a problem of too little purchasing power in the hands of the public? And if true, would the proposed increase in wages be an effective method of sustaining general purchasing power and stimulating production and employment?

**Is There a Shortage of Purchasing Power?**

In considering this question, it is in order to point out, first, that government officials are talking on both sides of the fence. While the President is stressing the deflationary effect of an estimated shrinkage of $20 billion in annual wage and salary income and calling for wage increases as an offset, the Treasury is launched upon the Victory Loan drive, with emphasis upon individual subscriptions ɔ mop up "excess purchasing power" and, as Secretary Vinson said, give inflation "the knockout punch." If our trouble is to be too little purchasing power and deflation why are we trying to sell bonds to the people who could otherwise keep their money for spending? Why are we endeavoring to keep the bonds out of the banks whose purchases would expand credit and purchasing power and thus exert a counter-deflationary influence?

And why, if our problem is deflation, did the President, in his September 6th message to Congress, warn us as he did (and we think wisely) of the inflationary outburst that followed World War I?

We must (he said) keep in mind the experience of the period immediately after the First World War. After a lull of a few months following the Armistice of 1918, prices turned upward, scrambling for inventory started, and prices soon got completely out of hand. We found ourselves in one of the worst inflations in our history, culminating in the crash of 1920.

And why, again, did Mr. Snyder, who has been quoted above as forecasting purchasing power deficiencies and deflation if labor take-home pay is permitted to decline, say to Congress in urging continuance of price control legislation beyond June 30 next that "as long as there are more dollars than goods in circulation, the Government must hold the line against inflation"? Why did Chester Bowles, the OPA director, testifying on the same bill, assert that such continuing price control was necessary because "there's more hot money around than most of us dreamed there would be"?

With such conflicting statements from government officials on the matter of available buying power, it is small wonder if the public becomes confused.

In our view, the answer to the question, is there any impending shortage of buying power? is — no, for three principal reasons:-

1. The Federal Government is still spending far in excess of income, and is expected to show a deficit of some $30 billion this fiscal year. Despite the exclusion of the commercial banks from subscription to the war loans for their own account (except in limited amounts for saving deposits), a very substantial part of the deficit is being financed indirectly by expansion of commercial bank credit. This means that much more freshly created dollars of purchasing power turned loose in the markets, and is definitely inflationary.

2. People will undoubtedly spend a larger proportion of their currently received income than they did during the war. While the war was on people saved, both because of patriotic incentives and because many of the things they wanted to buy were not available. It was, indeed, thanks to this rise in the normal rate of saving that the "inflationary gap" between the total of disposable incomes and the supply of goods and services was bridged and the war financed without a terrific inflation of prices. Now, however, by the same token, there is room for a considerable decrease in the sum total of income payments to individuals without corresponding decrease in individual expenditures, and with the possibility even that such expenditures will increase. It would mean cutting down on the abnormal wartime rate of savings and devoting a more normal proportion of current income to spending.

3. People, in addition to spending more and saving less of their *current* income, may also dig into their *past* savings which have been accumulating by leaps and bounds during the

war and now reach the enormous total of $140 billion of liquid resources, made up of readily marketable (or cashable) government bonds and other securities, bank deposits, and currency. To what extent people will be willing to invade this huge pile of past savings is a matter for conjecture, but certainly the existence of this great hoard of reserves ought to be taken into account in talking about future purchasing power and figuring the possibilities for inflation or deflation.

In addition to the foregoing three points there is still another and more fundamental reason for not taking a calamitous view of some fall in money income payments. It should be borne in mind that the reduction that is talked of would be from a highly inflated wartime level — inflated not only by overtime wage payments but also by employment of more than the normal labor force. Such conditions afford no sound criterion for more normal conditions. The thing that will count from now on is not the relation of money incomes to the inflated war levels, but rather the relation of money incomes to costs, prices, and profits. To the extent that we achieve a relationship between these various elements that promotes production and distribution, the question of purchasing power takes care of itself.

#### Fears of Deflation Far-Fetched

Taking all these factors together, it is difficult to see solid basis for fears of inadequate purchasing power and deflation. Rather the danger seems just the other way around — that we shall have more purchasing power seeking satisfaction in goods and services than there are goods and services available. There is, and will continue to be for some time, a shortage of the kind of things people will be wanting to buy. Meanwhile, the preoccupation appears to be all in the direction of piling up the financial claims against production rather than getting production itself going. There is the scramble for higher wages, the scramble for foreign loans, the pressure for larger unemployment relief payments, subsidies, and deficit spending, all on the theory that they add to purchasing power.

At the same time, many people seem to think they ought to have more and more time for leisure. They want a shorter work-week (of course at the same take-home wages as before). Production is hampered by strikes, slowdowns, absenteeism, and general carelessness about doing a good day's work. No one worries about losing a job, for there is always another to be had, most people have some financial resources tucked away, and in the background there are usually liberal unemployment relief allowances to fall back on. Industries are crying for labor, while workers "rest up" and go fishing, or look around choosily for jobs that will pay the war wages to which they have been accustomed.

The truth is that there can be no real gain in purchasing power or living standards, no matter how much money we give people, until we can get production moving ahead. Purchasing power exists in a meaningful sense only when there is something to purchase. Under any other condition, additions to "purchasing power" merely set the stage for inflation. The people of Europe are getting a fearful lesson in this, but in our more fortunate position the realization does not seem to sink in.

Actually, signs of inflation are present on every hand. We see them in the volume of retail trade moving. We see them in the amount of travel, in the congestion of the railroads and of the hotels. We see them in the difficulty in holding price ceilings, and in the readiness of people to resort to costly subterfuges to get the goods they want when they want them. We see the signs of inflation in real estate. We see them in the stock market, where prices have risen to the highest levels in 8 years. And all this, be it noted, is without use of credit. People have the money and are paying down cash on the barrel. One needs but look around and see what is going on to wonder why people are worrying so much about deflation and so little about inflation.

#### Wages and Purchasing Power

But assuming for the sake of discussion that our problem is inadequate purchasing power, would anything be gained by jacking up wages all around? This is a very old argument, which keeps cropping up both because the idea that boosting wages will, ipso facto, create more purchasing power is superficially plausible, and because the groups advocating higher wages — usually for themselves — are easily persuaded that the increases are for the general good.

The fact is, of course, that an increase in wages may or may not mean more purchasing power, depending on the circumstances. An increase that comes about in reflection of increased productivity, without raising costs and prices, is one thing. But an increase that is forced or granted without regard to productivity is quite another matter.

Certainly wage increases do not mean more purchasing power if they squeeze profit margins to the point where business cannot go ahead and workers are thrown out of jobs. And it is usually the smaller concerns that feel the pinch most since these are generally operating on slenderer margins of resources and are less able to make adjustments. Wage increases may reduce employment to the extent that labor-saving devices, etc., are introduced.

Certainly wage increases do not mean more purchasing power if they involve simply pass-

ng along higher prices to the consumer. In that case all we have is a robbing of Peter to pay Paul.

Certainly wage increases do not mean more purchasing power if they force prices to a level where buyers strike and production and trade are stalled. Of what use, for example, to raise wages in the building trades to increase purchasing power if the result is to halt building?

Commenting recently in a radio broadcast on the obstructive effects of spiralling wages, costs, and prices on the New York City program for construction of thirteen low-cost public housing projects, Mayor F. H. La Guardia revealed the City's inability to obtain bids on the first of these projects on a basis that would permit them to go ahead. Stating that the lowest bid would have run the final cost of the first project $810,000 above the New York City Housing Authority's estimate of $3,860,000, extension of such increases on the same scale to the other projects planned in the Authority's $116,390,000 schedule would mean, the Mayor said, that "the whole program would be shattered to smithereens."

The question is, how many other worthwhile projects throughout the country may be "shattered to smithereens" if inflationary forces are allowed to get out of hand? Clearly, occurrences of this kind are not going to add anything to purchasing power, nor (to repeat the President's phrase) are they "going to do anybody any good — labor, business, agriculture, or the general public."

#### Lower Prices a Source of Purchasing Power

Finally, in all the talk about purchasing power, it should be remembered that purchasing power can be increased by lowering prices as well as by raising wages. Moreover, whereas the purchasing power advantages that flow from wage increases are limited to the groups affected, those which flow from price reductions are spread over the entire population wherever there is a buyer of the product.

What happened in the automobile industry in the '20s is the classic example. There the benefits of rapidly improving technology were shared both with labor and with the public. Though the industry was a leader in paying high wages to its workers, nevertheless a substantial part of the economies resulting from manufacturing progress was passed on to the motor vehicle buyer in the shape of a cheaper, better car.

Everyone recalls what happened to automobile prices and the quality of the product, and what it did for the country. It put America literally on wheels, and wrought tremendous changes in our way of living. And no group benefited more than labor. One has but to glance into the motor car parking lot of any great industrial establishment to see the evidence.

Never, nowever, could all this have come about under a labor program that recognizes increased purchasing power only in higher wages and would monopolize in wage advances the gains resulting from technical advance. Had the automobile industry been forced to operate on this principle over the past fifty years, we would still be driving around in horse and buggies.

### The Wage Arguments

The argument as to whether the industries can pay increased wage rates, and if so how much, without raising prices, has continued without respite. Actually the argument makes little progress, for it is necessarily based more upon assumptions and projections — or in simpler language, opinions and guesses — than on indisputable facts. No one yet knows how much the industries will produce and sell in 1946 and later, what the cost of materials and labor will be, or what profit will be left after costs are met and taxes paid. The prospect varies from industry to industry, and from plant to plant. The labor unions naturally make assumptions and claims as to productivity volume and profit margins which in their eyes justify increases in wage rates. Industrial managers, who realize that there would be slim possibility of reducing rates again if the assumptions should prove mistaken, naturally feel that guesses involving so much uncertainty and conjecture provide an unstable foundation for putting higher wage rates into effect.

Nor is the conflict one that could always be settled by agreement as to facts or prospects in particular cases. The broad question of how the rewards of production should be distributed among workers in the form of wages, owners in the form of profits, and consumers in the form of lower prices is involved. Consumers other than the union workers meanwhile have little voice in the matter, although it doubtless occurs to many that if the means of paying higher wages actually exist, to the extent claimed by the unions, the whole situation would be benefited by having them eventually translated into lower prices through competition, rather than passed on wholly to the workers.

#### The O.W.M.R. Memorandum

The influence of the Federal Government has been injected into the argument in a manner which is deserving of notice. Sometime in October economists of the Office of War Mobilization and Reconversion submitted to the O.W.M.R. Advisory Board a statement entitled "Facts Relating to Wage-Price Policy", which concluded that three "measurable factors" would permit an increase of 24 per cent

in wages without raising prices or reducing profit margins. This memorandum has never been officially released. However, a "leak" occurred, which was described by Business Week as of "Niagara like" proportions. The memorandum has been quoted to some extent in the press, and a private Washington news service has reproduced it in full and distributed it to its subscribers.

This memorandum because of its government origin naturally possesses an influence to which it is not really entitled, inasmuch as it has never received official recognition and carries no official authority. The labor unions, however, are making use of its calculations and arguments, and business men who are involved in wage disputes should familiarize themselves with it.

The memorandum starts with an analysis of wartime changes in weekly and hourly pay, in the cost of living, in income taxes, and in the net "real" purchasing power of both the take-home pay and of wage rates. The figures are based on familiar data from the Bureau of Labor Statistics, and need not be repeated in our limited space. After discussing the probable extent of the decline in weekly earnings due to shorter hours and other changes since the war, the memorandum presents its data in support of the claim that industry can pay higher wages. This claim is based upon calculations as to the effect of the three "measurable factors"; upon a discussion of various "unmeasurable factors"; and upon an estimate of profits in 1946.

### Three "Measurable" Factors

The three measurable factors which in the opinion of the memorandum would permit a 24 per cent increase in wages are as follows: reduction of overtime, 4.5 per cent; elimination of one-half of the wartime "upgrading" and similar wage increases (other than changes in basic rates), 9.5 per cent, and repeal of the excess profits tax, 10 per cent.

The reduction in average hourly wage rates due to reduction in premium payments for overtime is estimated by assuming that in 1946 the amount of overtime will be cut from the April 1945 level to about the same amount as in January 1941. The argument of the authors is that the amount of the premiums "saved" can now be added back in, by spreading it over the regular work week, without increasing costs. We pointed out in this Letter last month, however, that when overtime for the 48-hour week was established it was argued that the premiums would not increase costs because overhead would be spread over a larger production. The argument cannot work both ways.

Moreover, the industries will have to work many plants overtime, more than before the war and more than people generally may realize, if the volume of business is as large as the authors of the memorandum expect. This is because the capacity to produce everything needed cannot, in the nature of things, be perfectly balanced. Some plants have to work 45 or 48 hours to supply parts for assembly lines working only 40 hours, and vice versa.

In the industries which have made no civilian products since 1941, and whose products are now to be priced at or close to 1941 or 1942 levels, the overtime paid on war work has little relevance to the question. It is idle to talk of a saving in costs as compared with 1945 on goods of which there was no production in 1945. In these cases adjustments of many kinds are necessary. The claim that saving in overtime, if any, will reduce average hourly wages as compared with the war period is mathematically correct, but the effect may be submerged in other changes. The problem of these industries is their level of costs as compared with the period on which their prices are based.

The assumption that one-half of the increase in wages due to upgrading, merit increases, incentive pay plans, etc., can be removed, and that this would permit an increase in basic wage rates of 9.5 per cent, invites a similar comment. In the industries which are making the same product in about the same volume as during the war there is no reason to think that much downgrading, retraction of merit increases, etc., is immediately likely, for such changes necessarily occur slowly. Again, the plants which have to reconvert, and which can make these changes more rapidly, will produce civilian goods to sell at or close to 1941 or 1942 prices.

Finally, the elimination of excess profits taxes will be an empty benefit unless excess profits are earned, which involves another assumption. Unless they are earned, there can be no gains to give to labor on that score.

### Flaws in the Argument

Evidently the three factors cited as making it possible to increase wages 24 per cent could apply in practice to relatively few companies. One factor may apply to one company, and one to another, but those in which overtime can be cut, downgrading carried out, the war level of selling prices maintained, and excess profits taxes eliminated, all in conjunction, cannot be numerous. For one thing, excess profits taxes were paid by only about 51,000 corporations last year and far fewer this year, out of 469,000 active corporations.

The general weakness of this kind of argument is that it takes no account of the differences between the various industries and between plants within the industries. Even if it were true that the average manufacturer could raise wage rates as stated, the statement

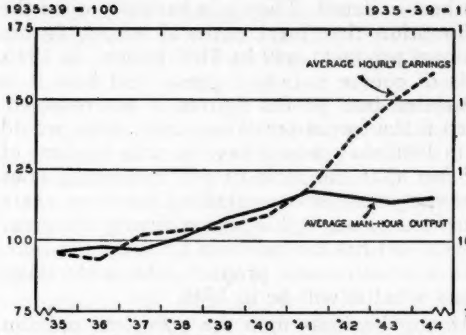
would be meaningless, for every below-average company which had to meet the general increase would have no alternative except to raise prices or to produce at a loss, which could not go on for long. The country cannot expect to have its wage standards set by reference to the ability to pay of the most prosperous or fortunate companies only. Such a method would be unfair to the efficient producers, which are entitled to a superior return because it is in the interest of everyone that they should be rewarded for their efficiency and have a superior opportunity to grow. It would be unfair to the smaller producers, who could not withstand the squeeze, but who are very important in the life of this country and also want to grow. It would be impracticable, for production would suffer.

### The "Unmeasurable" Factors

We turn now to the "unmeasurable" influences on costs cited in the O.W.M.R. memorandum. These include, among those termed "unfavorable", lower profit margins on civilian lines as against wartime lines; large turnover of labor and necessity of training in the transition period; reconversion expense and low volume and high unit cost of output during reconversion; and finally increased overhead per unit resulting from smaller output. The "favorable" factors listed are the retirement of inefficient workers; reduction of worker fatigue through shorter hours; and finally increases in productivity through new methods, techniques and materials.

These influences on costs are so powerful that it is difficult to see what value there can be in the mathematical calculations of the O.W.M.R. as long as they remain uncertain. The question of productivity alone provokes endless argument, but productivity can only be known after time has elapsed and experience accumulated. Many people probably have been led by general statements on the subject to believe that there has been a great increase in physical output per man-hour during the war. Of the war industries this was happily true. However, what was accomplished with war output, as management and labor familiarized themselves with war work and applied mass production methods to it, is no guide as to what productivity may be on civilian goods.

The fact that productivity has actually declined in many industries which continued to make their normal peacetime products during the war does not appear to be sufficiently understood. The U. S. Bureau of Labor Statistics has recently published figures on man-hour output for selected manufacturing groups. The accompanying chart shows an average (computed by ourselves) of output per man-hour and of hourly earnings in 18 civilian goods industries.




**Indexes of Average Man-hour Output and Average Hourly Earnings in Eighteen Civilian Gocds Manufacturing Industries. 1935-39 Equals 100.**

Source: U. S. Bureau of Labor Statistics. Averages of the indexes for the following industries: Baking, canning and preserving, confectionery, flour milling, ice cream, meat packing, sugar refining, tobacco products, cotton goods, woolen goods, leather tanning, shoes, paper and pulp, printing and publishing, fertilizer, paint and varnish, lumber, and cement.

It will be seen that the peak of man-hour output in these industries was reached in 1941 and that in the following three years there was a slight decrease. Average hourly earnings, however, rose 34 per cent in those three years. The gap that has developed between these two lines signifies a large increase in labor cost per unit of output. This has been absorbed by higher volume, higher prices, or lower profits, depending on circumstances. But in essence rising unit costs, when they are general, signify inflation. The problem is to bring unit costs down again by more efficient work and technological progress.

Labor leaders argue that prospective increases in efficiency should be anticipated by wage increases now, but the chart shows that in these industries the higher wages already established have not been supported by the productivity curve.

### An Estimate of Profits

Associated with the argument that wage increases can be drawn from the sources already named, the memorandum makes an estimate of corporation profits in 1946 to show that they would not be depressed. The estimate is that corporations in the aggregate can give a 10 per cent increase in basic wage rates and still earn in 1946 \$17 billion before taxes and \$10.2 billion after taxes. The figures compare with estimated wartime peaks of \$24.9 and \$9.9 billion, respectively, in 1944. For manufacturing corporations only the estimates are that a 14 per cent wage increase can be given and still leave profits of \$10.5 billion before taxes ..nd \$6.3 billion after taxes, compared with \$15 and \$5.8 billion, the wartime peaks.

Since we are not told how these estimates were arrived at, it is not possible to comment on them in detail. They rest basically upon the assumption that total national output (gross national product) will be $160 billion in 1946. This of course is only a guess, and how it is translated into profits figures is not revealed. Even if the forecasters knew what sales would be in 1946 they would have to take account of the fact that the ratio of net income to sales over the years (even excluding the three years of deficits or negligible return during the great depression) has ranged from 1.5 to 5.5 per cent. It is a venturesome prophet who undertakes to say what it will be in 1946.

Among business men the prevalent opinion is that the earnings outlook in many industries is bright, in some poor, and in many uncertain. Compilations of aggregate corporation profits are of great value in economic studies but the variations from company to company make either compilations or estimates of little use in deciding wage arguments.

### "Ability to Pay"

It is regrettable that a government agency should have contributed, even unofficially and only through a "leak", toward creating an impression that the major matter to determine in the wage controversy is industry's ability to pay. If labor is to receive every gain in ability to pay there will be little incentive for management to increase productivity, nor will consumers benefit, other than the workers directly concerned. Producers of superior efficiency obviously have more ability to pay than others, but if they are to pay higher wages than others (except as they may do so to attract better workers) they will be denied the superior profits which society should allow them.

Instead of putting the emphasis on "ability to pay", a greater contribution towards settling wage arguments soundly would be to define the objective which labor and management should seek. Incomparably, it is the interest of all the people that is important. The true objective of economic effort is to increase living standards of all groups, which means that there must be room for both lower prices and higher wages, as well as return to capital. Lower prices normally follow high profits, through the increased competition which is generated. To divert all the gains of progress to labor short-circuits that process.

Another objective of policy for the common welfare should be continuity of employment. To force wage rates up to levels which cannot be supported when economic conditions change and volume turns down is short-sighted, for the temporary gains eventually will be given up in unemployment.

## Forecasting as a Basis of Public Policy

The fact that the extent of unemployment during the reconversion period was enormously over-estimated by the government agencies which issued predictions around V-J day has already been mentioned briefly. There is a tendency to expand the forecasting activities of government agencies in fields where they may have a greater influence; examples are the recent statements as to future earnings of the industries and their ability to pay wage increases. Moreover the Murray Full Employment Bill proposes that such forecasts should be made the basis for deciding upon national policies of immense consequence. Hence it is of interest to examine the record.

### The Predictions and the Record

The following quotations, describing official forecasts of the unemployment to be expected when war contracts were cut back V-J day, are from the New York Times:

Washington, Aug. 11—(AP) Government officials estimated today that perhaps 5,000,000 munitions workers will lose their jobs within sixty days after Japan surrenders . . . Of the 5,000,000 slated for release, it was said that great numbers — perhaps half — would leave the labor market and would not be classified as jobless. The others would be added to the current unemployment rolls to swell the total to around 4,000,000 persons.

Special to the New York Times, Washington, Aug. 15— The War Manpower Commission estimated today that unemployment might exceed 5,000,000 in the course of the next three months and reach 6,200,000 by mid-December.

Washington, Aug. 30— John W. Snyder, reconversion director . . . told the Ways and Means Committee . . . that the inescapable fact was that unemployment would be severe, reaching perhaps 6,000,000 by the end of the year and 8,000,000 by early spring.

The estimate of 8,000,000 unemployed next Spring was repeated in the fourth report of the Office of War Mobilization and Reconversion, dated October 1, 1945.

The forecasts described were made by agencies with adequate staffs of trained economists, they were based on assumptions prevalent in government circles at the time, and presumably they were as competent as any that could have been made. The figures by which to test them are now available. Official figures of unemployment are compiled by the Bureau of the Census, U. S. Department of Commerce, based on cross-section surveys in the first or second week of each month.

In July, the month before Japan's defeat, unemployment was calculated at 950,000; in August, just prior to Japan's defeat, the number was 830,000; by early September the number had jumped to 1,650,000; and in October there was reported a decrease in unemployment to 1,500,000. November is likely to show some increase, following rapid demobilization,

but it is already established that the total was far short of "4,000,000 in sixty days," and it is wholly unlikely to be anywhere near "5,000,000 in three months."

As to present views of the prospects of unemployment next Spring, John D. Small, Civilian Production Administrator, told a news conference on November 15 that he felt that the peak of unemployment should not exceed 4,000,000 or 5,000,000 people.

### The Murray Bill

The Murray Full Employment Bill, to which reference has been made, has been passed by the Senate, and is now in committee in the House. It would require forecasts of a National Production and Employment Budget as follows:

(1) for the ensuing fiscal year and such longer period as the President may deem appropriate, an estimate of the number of employment opportunities needed for full employment, the production of goods and services at full employment, and the volume of investment and expenditure needed for the purchase of such goods and services;

(2) current and foreseeable trends in the number of employment opportunities, the production of goods and services, and the volume of investment and expenditure for the purchase of goods and services, not taking into account the effects of the general program provided for in paragraph (3) hereof; and

(3) a general program . . . for assuring continuing full employment, together with such recommendations for legislation as he may deem necessary or desirable. Such program shall include whatever measures he may deem necessary to prevent inflationary or deflationary dislocations or monopolistic practices from interfering with the assurance of continuing full employment.

The President would be required to transmit to Congress, at the beginning of each regular session in January, forecasts for the ensuing fiscal year, which would cover a period beginning six months after the forecast is offered, and extending through the subsequent twelve months, or for such longer period as the President may deem appropriate.

Critics of the proposed National Budget who have felt that such forecasting is impracticable have used the past record of Treasury forecasts of the federal budget to illustrate their point. During the years from 1921, when the Bureau of the Budget was created, to 1941, government receipts varied from the original budget estimates (submitted about six months before the beginning of each fiscal year) by an average of 13 per cent. In expenditures the average variation was 18 per cent. Now comes the record of estimates of unemployment only three months ahead. The task of forecasting the figures specified in the Murray Bill, including employment, production and business and consumer expenditures, six to eighteen months (or more) ahead, would make the difficulties of predicting unemployment three months ahead pale into insignificance.

It should be unnecessary to say that our purpose is not to reflect on the competence or devotedness of the government economists concerned, but to point out the impossibility of the task required of them, and the unwisdom of basing public policies, which would dominate the economic life of the country, upon such predictions. What happens depends upon what millions of people do, which is unpredictable. Proposals for increases in unemployment compensation at federal expense stemmed principally from the unemployment estimates. Also, it is a reasonable assumption that if the national budget provisions had been in operation for long before V-J day a huge public works program might have been ready to release, in harmony with the forecasts of high unemployment.

The weight of opinion now, however, is that it would have been a mistake to have increased unemployment compensation, and the House of Representatives has refused to act upon the bill. As for a huge public works program, there is increasing recognition that the principal effect would be to delay private construction and to intensify competition for the presently limited supplies of labor and materials. Estimates of the time required for the industry to reach a volume commensurate with the urgent requirements for private construction now range up to two or three years. "Make work" programs under these conditions would add to the inflationary pressures already existing by reason of scarce materials, rigid prices, housing shortages, and insufficient labor. The example is revealing of the grave mistakes to which miscalculations in forecasting, under the Murray Bill, might lead.

## Southeastern Asia and Commodity Trade

The first shipment of rubber from Southeastern Asia to the United States since early 1942 was reported last month, symbolizing the reopening to this country of sources of essential imports which have been closed nearly four years. We are not accustomed to thinking of the United States as economically dependent upon other areas, but the degree of our dependence upon Southeastern Asia has been brought home during the war. For lack of access to its rubber, tin and other strategic products, we have had to build up one new major industry and several lesser ones. We have had to develop substitutes or new sources of supply in other regions, at great cost and in many cases with poor results in quantity or quality, or both. We have had to make shifts in our own agricultural production. Despite these war measures, reopening of our former sources of supply is essential to assure adequate amounts and qualities of these materials which we can ill afford to do without.

The importance of Southeastern Asia does not lie in its share of total world exports, which was less than 5 per cent before the war, but rather in its unique concentration on the production of indispensable commodities which are little produced elsewhere.

The table below gives the share of the Netherlands East Indies, Burma, British Malaya, French Indo-China, the Philippines and Thailand — the countries usually included in Southeastern Asia — in the world exports of leading commodities, and their contribution to United States imports of these goods.

**Trade in Principal Products of Southeastern Asia**

(In Millions of Dollars)

| | World Exports, 1938 | | | U.S. Imports, 1937-38 | | |
|---|---|---|---|---|---|---|
| | World Total | S.E. Asia Total | S.E. Asia Percent | World Total | From S.E. Asia Total | From S.E. Asia Percent |
| Rubber | $ 287 | $264 | 92 | $185 | $167 | 90 |
| Rice | 197 | 173 | 88 | 2 | ½ | 25 |
| Petroleum & prod. | 1,140 | 126 | 11 | 43 | 1 | 2 |
| Oilseeds | 318 | 89 | 28 | 44 | 11 | 25 |
| Tin | 195 | 88 | 45 | 73 | 58 | 79 |
| Sugar | 340 | 75 | 22 | 140 | 53 | 38 |
| Vegetable oils | 149 | 51 | 34 | 74 | 23 | 31 |
| Tobacco | 359 | 37 | 10 | 39 | 5 | 13 |
| Tea | 202 | 34 | 17 | 20 | 5 | 25 |
| Spices | n.a. | n.a. | n.a. | 12 | 4 | 33 |
| Total above | 3,187 | 937 | 29 | 632 | 327½ | 52 |

n.a. not available. Source: "The Network of World Trade," League of Nations 1942, Foreign Commerce Year Book, 1938, "U. S. Foreign Commerce and Navigation," 1937-39.

NOTE — The table is by no means all-inclusive. Southeastern Asia also contributed in the prewar years over 95 per cent of the world supply of manila hemp or abaca, 90 per cent of the world exportable supply of cinchona bark from which quinine is extracted, 85 per cent of the pepper, 75 per cent of the kapok and around 25 per cent of the sisal. Its share of the world supply of tin was usually larger than is indicated by the table, which covers only one year (1938); the average for the 1937-39 period was around 65 per cent.

The rapid development of Southeastern Asia has been due to a combination of factors which are not present in other tropical areas. An ample supply of cheap labor probably has been the most important. Others include the presence of mineral wealth and natural fertility of the soil. Political and social stability before the war encouraged the investment of capital amounting to nearly $4 billion. Finally, managerial ability and the highly scientific cultivation of some plantation crops, such as rubber, sugar, and palm oil, contributed to low production costs.

### Aftermath of Japanese Occupation

The Japanese left the countries of Southeastern Asia in a state of economic decay. Trade collapsed; inflation and plunder were rife. Rural areas have slipped back into a subsistence and barter economy. The Japanese utilized only a small part of the rubber, tin, etc., and in many sections acreage under commercial crops had to be shifted to food crops or to cultivation of products from which the Japanese were cut off by the war. Many plantations fell into neglect and labor forces were dispersed to Japanese war projects.

Inflation did the rest. Since only small quantities of trade goods were brought in from Japan in payment for the products taken out, the native farmer and worker lost the incentive to produce. Farm animals were taken away. With rice fields unploughed, famine conditions developed in parts of Burma and Indo-China which normally had huge food surpluses for export.

### Rubber and Tin Stockpiles Found

American industry naturally is anxious to learn how soon and in what quantity raw materials once again will become available from Southeastern Asia. This is particularly true with respect to rubber and tin.

The rubber industry in Southeastern Asia has been found neglected but basically intact, with relatively minor damage to the trees. The greatest obstacle to resumption of production seems to be the recruitment of trained labor, dispersed during the occupation. Many plantations have remained untapped and the large yields expected as a result of their enforced idleness should offset the diversion of a small rubber acreage to food crops. The largest rubber stockpiles reported so far have been found in French Indo-China and Malaya. Altogether, some 250,000 tons of rubber have been uncovered, equivalent to over a full year's production from the areas on which the United Nations had to draw during the war. In the Netherlands Indies political strife makes an appraisal of the conditions of the rubber industry difficult. Additional stocks may eventually turn up there since small native holdings accounted for a much higher proportion of production than in other areas.

Present indications are that shipments of tin will be resumed more slowly than those of rubber. Comparatively little tin so far has been reported uncovered in stockpiles, although some has been found in Malaya, French Indo-China, Burma and Thailand. One of the Malayan tin smelters at Penang is reported in operating condition; another at Singapore appears to have been damaged. Not much information is available on the condition of the dredges but some apparently can be put into operation shortly, or within months. Where destruction has been complete, at least one to two years will be required to place new dredges in operation. A much shorter time will be needed to replace gravel pumps, which before the war accounted for about as much tin as was produced by the more efficient dredges.

### Prospects for More Sugar, Vegetable Oils and Rice

The most dramatic commodity development to come out of the reoccupation of Southeastern Asia so far was the announcement of Secretary of Agriculture Anderson early in October that a stockpile of 1,600,000 short tons of sugar has been found in the interior of Java. This finding of what amounts by

prewar standards to a full year's production partly compensates for the disappointingly slow rehabilitation of the sugar industry in the Philippines. However, most of the Java sugar is stored in the interior where the Indonesian nationalist movement is strongest; and with hostilities around some of the ports threatening destruction of the sugar in shipping positions, it seems clear that no early benefit, either in this country or in Europe, is to be expected.

Present information throws little light on how soon Southeastern Asia will be able to regain its position as the world's largest vegetable oil shipper. Some progress has been made in reorganizing copra collection in the Philippines, and shipments to this country are increasing, although far from reaching their prewar volume. It has been reported that Sumatran palm oil production ceased almost entirely during the occupation. No large stockpiles have been reported from any of the producing areas.

Through the liberation of Burma, French Indo-China, and Thailand access has been regained to the world's rice bowl. But reports from Burma, the largest producer, indicate that this year's crop was well below prewar levels and that rice exports consequently will be reduced to only about 15 per cent of normal.

### Long-Range Readjustments

Long-range adjustments in world commodity markets will be necessary when exports of Southeastern Asia once again approach prewar levels. A similar situation existed in wheat and sugar after the last war, which stimulated output in new areas in excess of the world's capacity to consume. Once the old sources of supply came back, the new production plagued the wheat and sugar markets throughout the inter-war period.

The most important duplication of productive facilities in this war has been in rubber. The synthetic rubber plants of the United States, which cost $700 million, have an annual capacity of over 1,100,000 tons, or more than the entire world consumption of crude rubber before the war. Crude rubber production was stimulated in South America and Africa, and synthetic output increased in other countries. Altogether the world's rubber productive capacity has been nearly doubled to around 2,750,000 tons, compared with about 1,500,000 tons of crude rubber before the war. While rubber consumption likewise is expected to reach much higher levels than before the war, few expect it to be much above 1,500,000 tons annually over the next few years.

Obviously, readjustments are required. Crude rubber and synthetic will be competing for markets. The brunt will fall on the high-cost producers of both. At the present stage of synthetic rubber technology, crude rubber is favored for the major uses because it makes a higher quality product and is more easily processed. However, research is constantly improving the quality and lowering the price of the synthetic product. Some plants already are producing synthetic rubber at a cost, excluding amortization charges, well below the 1939 level of crude rubber prices. Their future will depend both upon continued technological progress and upon Government policy with respect to disposition of the plants and the terms upon which private industry acquires them, which will influence costs.

Major adjustments face American agriculture when cheap rice and vegetable oils again start moving in volume from Southeastern Asia to the Western Hemisphere. During the war, our rice production rose 50 per cent and vegetable oil production more than tripled, accompanied by a sharp rise in prices. Production likewise has increased sharply in a number of Latin American countries.

### Prospects for Recovery

Prospects of eventual surplus producing capacity raise the question as to how far rehabilitation of the primary goods industries of Southeastern Asia can be carried. The question is not easy to answer. Involved is the consideration of the purchasing power and the standard of living of the some 150 million people, who live in the Southeastern Asia region. They depend for cash income upon the sale of their products to the industrial countries of the West. It may not be easy for them to shift to new export industries unless capital investment from overseas is forthcoming. Even if capital is available it will take time to clear plantations, equip mines and processing plants, restore transportation and retrain labor forces. More acreage will have to be kept under food crops until the intra-regional trade in foodstuffs is restored. Trade goods will have to be brought in to arrest inflation and to restore the native's incentive for raising more than merely subsistence crops.

In recent weeks spreading political disturbances have become another obstacle to the rehabilitation of Southeastern Asia and the restoration of its trade. Solution of the political problem will be difficult and slow. It may involve changes in colonial policies and even a new direction in economic development. At any rate the unique position which Southeastern Asia occupied in international trade before the war is bound to undergo some changes. Nevertheless access to its varied wealth of raw materials is necessary for the orderly progress of world rehabilitation.

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